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IN THE

Supreme Court of the United States

OCTOBER TERM, 1937

No. 55

MARY DUKE BIDDLE,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE PETITIONER

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ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE PETITIONER.

Opinions Below.

The opinion of the Board of Tax Appeals (R. 103-119) is reported in 33 B. T. A. 127. The opinion of the Circuit Court of Appeals for the Second Circuit (R. 580-585) is reported in 86 F. (2d) 718.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered December 14, 1936. On February 3, 1937 Mr. Justice STONE of this Court signed an Order extending the time for sixty days within which petitioner might make ap-

plication for a writ of certiorari. The petition for certiorari was filed May 12, 1937, and was granted October 11, 1937. Jurisdiction is conferred upon this Court by Sec. 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Question Presented.

The sole question presented is whether under Sec. 131 of the Revenue Act of 1928 all or any portion of United Kingdom Income Taxes deducted and withheld from dividends paid by British corporations to petitioner should be allowed as a credit against United States Income Taxes as income taxes paid or accrued to a foreign country, and the balance thereof, if any, not available as a credit, deducted from gross income under Sec. 23 (c) of said Act.

Statutes Involved.

Petitioner claimed a credit against income taxes due the United States under the provisions of Sec. 131 (a) and (b) of the Revenue Act of 1928, c. 852, 45 Stat. 791, which follow:

> "SEC. 131. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.
>
> (a) ALLOWANCE OF CREDIT.—The tax imposed by this title shall be credited with:
>
> (1) *Citizen and Domestic Corporation.*—In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war-profits, and excess-profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States; and
>
> * * * * * * *

(b) LIMIT ON CREDIT.—In no case shall the amount of credit taken under this section exceed the same proportion of the tax (computed on the basis of the taxpayer's net income without the deduction of any income, war-profits, or excess-profits tax any part of which may be allowed to him as a credit by this section), against which such credit is taken, which the taxpayer's net income (computed without the deduction of any such income, war-profits, or excess-profits tax) from sources without the United States bears to his entire net income (computed without such deduction) for the same taxable year."

Petitioner claimed as a deduction the balance of British Income Taxes not available as a credit, under Sec. 23 (c) (2) of the Revenue Act of 1928, which follows:

"SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * * *

(c) TAXES GENERALLY.—Taxes paid or accrued within the taxable year, except—

* * * * * * *

(2) so much of the income, war-profits, and excess-profits taxes imposed by the authority of any foreign country or possession of the United States as is allowed as a credit against the tax under section 131; and * * *".

Statement.

The Circuit Court of Appeals for the Second Circuit (R. 580-585) affirmed a decision of the Board of Tax Appeals determining a deficiency of $27,722.94 for the year 1929, upon the following facts:

Petitioner is a citizen of and resides in the United States. During the year 1929 petitioner owned shares of stock of certain British corporations. Those corporations declared and paid to petitioner dividends on her shares and deducted and withheld from each such dividend United Kingdom Income Tax at the standard rate appropriate to each such dividend, pursuant to the United Kingdom Income Tax Act of 1918, as amended (R. 26-29; Appendix "A", p. 199 of petitioner's Exhibit No. 1 and p. 29 of petitioner's Exhibit No. 10). The stocks, rates of dividend, dates of payment and amounts deducted and withheld are set forth in detail in the Record pp. 26-30. Each dividend warrant transmitted to petitioner by the respective corporations was required to be, and was, accompanied by a statement showing:

> "(a) the gross amount which, after deduction of the income tax appropriate thereto, corresponds to the net amount actually paid; and
>
> (b) the rate and the amount of income tax appropriate to such gross amount; and
>
> (c) the net amount actually paid.",

pursuant to Section 33 (1) of the Finance Act of 1924 (R. 32-42, 136-140, 153-157; Appendix "A", p. 19 of petitioner's Exhibit No. 7).

Petitioner reported in her income tax return as "Dividends from Foreign Corporations" the dividends declared by the British corporations. Her credit for taxes paid to a foreign country was computed pursuant to Sec. 131 of the Revenue Act of 1928. It was ascertained that she was entitled to a credit of $33,628.60 of the United Kingdom Income Taxes deducted and withheld from her dividends. The balance of such foreign taxes, viz.: $13,751.67, which

were not available as a credit, were deducted from gross income pursuant to Sec. 23 (c) of the said Act. Claim for credit under Sec. 131 was made upon Form 1116 which was duly filed, together with supporting documents evidencing the payment of British Income Tax (R. 30). Respondent disallowed the entire amount claimed as a credit on account of foreign income tax, and excluded it from petitioner's gross income, which action gave rise to the entire deficiency asserted here. Petitioner appealed to the United States Board of Tax Appeals, alleging error with respect to the Commissioner's determination.

The question presented to the Board of Tax Appeals involved the facts of the history, interpretation and construction of the income tax laws of the United Kingdom, the decisions of the British Courts, and the administrative practice of the Department of Inland Revenue of Great Britain insofar as applicable here. The English law was proved by official copies of the Acts of Parliament, decisions of the British Courts and the testimony of Frank Heyworth Talbot, an English barrister, who was for many years one of the chief executive officers of the Department of Inland Revenue. The Board of Tax Appeals found that Mr. Talbot was an authority on British income tax law (R. 106). **Based on all the evidence, the Board found as a fact that under the United Kingdom Income Tax Acts a shareholder receiving a dividend from a British corporation is regarded as having paid by deduction income tax appropriate to that dividend** (R. 110). In spite of this finding, however, the Board approved the Commissioner's action in disallowing the credit claimed by petitioner. The Circuit Court of Appeals for the Second Circuit expressly approved this finding of fact by accepting the expert's conclusion "that under British law the shareholder is regarded as a tax-

payer in respect to the amounts deducted from the dividends for income taxes 'appropriate' thereto" (R. 582) and that "the shareholder is regarded as an income taxpayer" (R. 583), but affirmed the Decision of the Board. This Court granted certiorari.

Summary of Argument.

Sec. 131 of the Revenue Act of 1928 provides that where a citizen of the United States has paid or accrued foreign income taxes during the taxable year, he shall be allowed credit therefor against his Federal income tax to the extent prescribed in said Section. Whether or not a foreign income tax has been paid is a question of foreign law. A question of foreign law is a question of fact. This fact, in the instant case, was found in favor of the petitioning taxpayer by the Board of Tax Appeals. There was ample evidence to support the Board's findings of fact, and this should have concluded the case.

The decisions of the Board and the Circuit Court are contrary to the settled practice of the Commissioner from the inception of the law allowing credits for foreign taxes in the year 1918 to the commencement of this case. The decisions are contrary to the published rulings of the Bureau of Internal Revenue. These published rulings and practice have received Congressional approval through successive re-enactments of the law without substantial change since 1918.

ARGUMENT.

POINT I.

Whether or not petitioner paid the British Income Tax under the laws and decisions of Great Britain is a question of fact. These laws and decisions were properly produced in the Board of Tax Appeals and explained by a qualified expert who testified that under them the petitioner had paid the British Income Tax. This is the only testimony in the record on this subject. Such payment was found as a fact by the Board. This finding was accepted by the Circuit Court of Appeals and it is conclusive on this question in this Court.

1. **The law of Great Britain controls the question of whether the petitioner paid British Income Tax.**

Whether or not a *foreign* income tax has been paid can be proved only by reference to the *foreign* law. In this case, the Board should have concluded, as it did in *Columbian Carbon Co.* v. *Commissioner,* 25 B. T. A. 456, 465, that:

> "The question here presented is governed by the laws of England, a foreign country * * *."

In *Elkins* v. *Commissioner,* 91 F. (2d) 534, which involved the very same point, and was considered upon the same Record as the instant case, the Circuit Court of Appeals for the Third Circuit said at pages 536, 538:

> "The only question we are concerned with is: Did the petitioner pay the income tax, and to ascertain this

we must see what happened in England; what kind of a tax was paid; who paid it?"

* * * * * * * *

"The answer is governed by the laws of England. It is by those laws that we must judge the nature of the tax, for only in those laws can we find the answer who pays the tax."

And in *United Shoe Machinery Corp.* v. *White,* 13 F. Supp. 97, 102, when the same question involved here was before that Court for determination, it said:

"* * * the proper solution of this problem depends essentially upon the British Act and British decisions."

In every case we have found relating to the question of whether or not a credit for foreign income taxes should be allowed, the fact finding body has determined that question by an examination and consideration of the *foreign* law. If it is determined that a *foreign* income tax has been paid under the *foreign* law, such determination is controlling. *Burns* v. *Commissioner,* 12 B. T. A. 1209, 1225; *Keen* v. *Commissioner,* 15 B. T. A. 1243, 1246; *Eitingon-Schild Co., et al.* v. *Commissioner,* 21 B. T. A. 1163, 1174-1175; *Columbian Carbon Co.* v. *Commissioner, supra; Mallouk* v. *Commissioner,* 34 B. T. A. 269, 273; *Commissioner* v. *Briskey Co.,* 78 F. (2d) 816 (C. C. A. 3rd); *United Dyewood Corp.* v. *Bowers,* 56 F. (2d) 603 (C. C. A. 2nd).

In the *Keen* case, *supra,* credit was claimed for a tax paid to the French Government based upon seven times the rental value of real estate owned by nonresidents. In that case, the Commissioner of Internal Revenue, as in this case, contended that the tax in question was not an "income tax" within the meaning of our statutes. In allowing the credit, the Board, after a review of the French law, held that:

> "Whatever may be the nature of the tax, it is imposed upon what the French Government determines to be income * * *. It is a part of a statute which imposes income taxes upon citizens and residents of France. In view of this situation we think that the tax was an income tax within the meaning of section 222 (a) (1) of the Revenue Act of 1921. The fact that under the [French] law the taxable income is determined in a manner different from the taxable income under the Revenue Act of 1921 does not change the nature of the tax."

Thus, notwithstanding the fact that the French tax appeared to be highly artificial in our eyes, the Board recognized the impropriety of attempting to interpret a different system and theory of taxation in the light of our own, and properly held that the foreign law was determinative of the issue before it.

In the recent *Mallouk* case, *supra,* there was also a question whether a tax was an "income tax" within the credit provisions of our statutes. The Board stated at page 273:

> "To resolve this question we must determine the nature of the controverted taxes as indicated by the Philippine statutes."

The Board recognized that it was bound by the evidence of the foreign law before it and followed the Philippine law without reference to our law.

And in *Burk Brothers* v. *Commissioner,* 20 B. T. A. 657, despite the fact that the tax there imposed by the Indian Government was based upon an artificial and arbitrary concept of income entirely foreign to our views, the Board held that the law of India controlled and that the tax was therefore an income tax within the credit provisions of our law. Credit for the Indian tax was allowed by the

Circuit Court of Appeals for the Third Circuit, in *Commissioner* v. *Briskey Co., supra.*

In the instant case, the Board and the Court erred in failing to apply the principle that the law of Great Britain controlled the question of whether or not the petitioner paid United Kingdom Income Tax.

2. **A question of foreign law is a pure question of fact.**

This principle was laid down by this Court in *Liverpool and Great Western Steam Co. (Limited)* v. *The Phenix Insurance Co.,* 129 U. S. 397, 445, 32 L. ed. 788, 793, when it stated:

> "The law of Great Britain since the Declaration of Independence is the law of a foreign country, and, like any other foreign law, is matter of fact, which the courts of this country cannot be presumed to be acquainted with, or to have judicial knowledge of, unless it is pleaded and proved."

Cuba Railroad Co. v. *Crosby,* 222 U. S. 473, 478, 56 L. ed. 274, 275; *American Banana Co.* v. *United Fruit Co.,* 213 U. S. 347, 356, 53 L. ed. 826, 832; *Pierce* v. *Indseth,* 106 U. S. 546, 550, 27 L. ed. 254, 256; *National Steam Navigation Co. (Limited)* v. *Dyer,* 105 U. S. 24, 29, 26 L. ed. 1001, 1003; *Ennis* v. *Smith,* 14 How. 400, 426, 14 L. ed. 472, 484; *Badische Anilin & Soda Fabrik* v. *A. Klipstein & Co.,* 125 Fed. 543, 544-545.

The Record in this case shows that petitioner followed the rules as to proof of the foreign law laid down by this Court in *Ennis* v. *Smith, supra.* The English law was proved by official copies of the Acts of Parliament, the decisions of the British Courts and the testimony of a duly qualified expert. The expert testified not only as to the meaning and effect of the English statutes and decisions,

but also as to the facts of the administrative practice in England, based on over twenty years' experience, a major portion of which was spent as one of the chief executive officers of the Department of Inland Revenue.

3. **The question of fact as to foreign law was found in favor of the petitioner by the Board and is conclusive.**

After examining the income tax laws of Great Britain relating to the question of who pays the tax when a British corporation declares and pays a dividend to its shareholders from which United Kingdom Income Tax has been deducted, the Board found as a fact that:

> "The stockholder receiving the dividend is regarded by the English income tax acts as having paid 'by deduction or otherwise' the tax 'appropriate' to the dividend." (R. 110.)

Furthermore, the Board found that if the stockholder be subject to British surtax:

> "* * * in making his surtax return the stockholder is required to include in his gross income not only the amount of the distribution received from the corporation but that amount plus the tax 'appropriate' thereto. On the other hand, the stockholder receiving the dividend may not, by reason of exemptions and relief provisions of the income tax acts, be required to pay the full amount of the tax represented by the tax 'appropriate' to the dividend. In such case the stockholder is entitled to file a claim for refund with the English authorities and upon the proof of claim is entitled to recover a part or all of the tax 'appropriate' to the dividend." (R. 110-111.)

In dealing with the two methods by which dividends may be declared, the Board, in an illustrative case of a dividend of £1,000 and a tax of £250, said:

"In either case the stockholders are regarded as having paid an aggregate income tax of £250 in respect of the dividends received by them." (R. 111.)

The Board had before it for its consideration all the applicable income tax law of Great Britain, decisions of the British Courts pertinent to the question presented, and the testimony of an expert witness. In view of the Board's findings of fact above set forth, it is submitted that no question may be raised at this time regarding the petitioner's status as an income taxpayer under the British law. In view of such findings, it is further submitted that it was manifest error for the Board to disregard its findings, based as they were on the documentary evidence and the testimony of the expert, and reach a contrary conclusion. In *Elmhurst Cemetery Co. of Joliet* v. *Commissioner,* 300 U. S. 37, 81 L. ed. , decided by this Court February 1, 1937, it is said: "It is the function of the Board to weigh the evidence and declare the result", and that where there is substantial evidence to support the Board's findings of fact they "must be accepted". See *Helvering* v. *Tex-Penn Oil Co.,* 300 U. S. 481, 81 L. ed. , decided by this Court March 29, 1937; *General Utilities & Operating Co.* v. *Helvering,* 296 U. S. 200, 206, 80 L. ed. 154, 157; *Helvering* v. *Rankin,* 295 U. S. 123, 131, 79 L. ed. 1343, 1349.

To satisfy the Court that there was ample evidence to support the Board's findings, there is set forth in Point III hereinafter a brief discussion of the history of English income tax law, certain sections of the British law itself, quotations from the English decisions and a brief excerpt from the expert's testimony.

4. The Circuit Court did not apply the applicable foreign law.

The Circuit Court of Appeals should have reversed the Board of Tax Appeals upon the Board's own findings of fact. The Court below in considering the evidence before the Board states "we shall accept the expert's conclusion", which conclusion, according to the Court's own statement, was "that under British law the shareholder is regarded as a taxpayer in respect to the amounts deducted from the dividends for income taxes 'appropriate' thereto", and that "the shareholder is regarded as an income taxpayer". (R. 582-584.)

After having explicitly accepted the expert's conclusion and recognized that for all purposes of the English Income Tax Acts the shareholder pays income tax when it is deducted from his dividend, the Court below disregarded these findings and concluded that "under our statutes and our principles of taxation the shareholder is not a [foreign] taxpayer entitled to credits and deductions". In arriving at this conclusion it not only disregarded the principle that the foreign law is controlling in determining whether a foreign income tax has been paid, but also failed to distinguish between British income taxes levied by direct assessment and those collected by deduction at the source, erroneously stating that "Our system of credits and deductions is built around a concept of direct liability for taxation and direct payment". This view of the Court below has since been expressly repudiated by two Circuit Courts of Appeals. In the *Elkins* case, *supra*, the Circuit Court of Appeals for the Third Circuit said, as to that view (p. 538):

> "We respectfully differ from the learned Judge's conclusions. In the first place the Government, as noted (4), *supra,* has conceded that direct payment is not essential. Indeed, the doctrine of constructive receipt and payment is recognized in our system. *Old Colony Trust Co.* v. *Commissioner,* 279 U. S. 716, 49 S. Ct. 499, 73 L. ed. 918. And in the second place, the Revenue Act expressly allows a credit for payment of foreign income tax."

The Circuit Court of Appeals for the First Circuit in *United Shoe Machinery Corp.* v. *White,* 89 F. (2d) 363, 366, flatly rejected such view, in the following language:

> "But in the *Biddle* case it was held, as has been said, that although the tax was a tax on the shareholders, it was not 'paid by' them within the meaning of our law. We are unable to agree."

We have no desire to labor this point, but call attention to the fact that "under our statutes and our principles of taxation", taxation by deduction at the source is common and in every sense the equivalent of a direct, physical or manual payment. This principle is illustrated by the income tax on employees under the Social Security Act, the provisions for taxing non-resident aliens, and the provisions in the earlier Revenue Acts for deducting income taxes from salaries. Indeed, the express provisions of Sec. 131 (b) of the Revenue Act of 1928 recognize the fundamental principles of payment of foreign income taxes by deduction at the source. This section requires a taxpayer claiming credit for foreign taxes against Federal income taxes to include as a part of his net income not only the amount he actually receives as dividends, but also the amount of any foreign tax deducted therefrom at the source.

The failure of the Court below to distinguish between direct payment and payment by deduction at the source is contrary to the decisions of this Court. See *Douglas* v. *Willcuts*, 296 U. S. 1, 9, 80 L. ed. 3, 8; *Burnet* v. *Wells*, 289 U. S. 670, 677, 77 L. ed. 1439, 1443; *United States* v. *Boston & Maine Railroad Co.*, 279 U. S. 732, 734, 73 L. ed. 929, 930; *Old Colony Trust Co.* v. *Commissioner*, 279 U. S. 716, 729, 73 L. ed. 918, 927-928. Also, when the Court below states that under British law a shareholder is not liable for a direct assessment on his dividends, it fails utterly to note the reason therefor, namely, the fact that "they have already been taxed by deduction at the source." (R. 175.) It further fails to make any reference whatever to the important provisions of Section 211 of the United Kingdom Income Tax Act of 1918 (R. Appendix "A", p. 133, Petitioner's Exhibit No. 1), providing for direct assessment of income tax on dividends where "tax has not been charged thereon or deducted therefrom" by the dividend paying company.

The sole question involved, as was pointed out by the Circuit Court of Appeals for the Third Circuit, in the companion case of *George W. Elkins*, is, did the petitioner pay a British Income Tax with respect to her British dividend income? The petitioner's status as an income taxpayer under British law having been conclusively established and found as a fact, it follows automatically that credit must be allowed under Sec. 131 of the Revenue Act of 1928 against her Federal income tax.

POINT II.

The decisions below invalidate the uniform and consistent administrative rulings and settled practice of the Commissioner for more than fifteen years.

The Commissioner and his predecessors in office allowed credits for United Kingdom Income Taxes deducted from dividends of British corporations, similar in all respects to those claimed by petitioner herein, from the effective date of the Revenue Act of 1918 until late in 1933, after this case was started.

The Commissioner's first official announcement of his approval of the allowance of these credits appeared in Solicitor's Memorandum 3040 published in IV-1 Cumulative Bulletin 198 (1925). In this memorandum, the then Solicitor of Internal Revenue, Nelson T. Hartson, Esquire, held:

> "In view of these decisions, it is the opinion of this office that where under the income tax act, 1918, of Great Britain, a tax is paid to the British Government by a corporation on the basis of its profits and gains which is deductible by the corporation from the dividends paid its shareholders, such tax is a tax against the shareholders and may be taken as a credit by a citizen shareholder of the United States under section 222 of the Revenue Acts of 1918 and 1921. Although the corporation is held chargeable to tax, the decisions cited above construe the provision permitting the deduction of taxes from dividends as being a payment of tax on behalf of the shareholders, or a collection at the source. It is concluded, therefore, that in the instant case where a citizen of the United States receives dividends from a British corporation, from which a proportionate part of the tax paid to

> the British Government has been deducted, such payment of tax comes within the contemplation of section 222 (a) of the Revenue Acts of 1918 and 1921 as a tax paid to a foreign country."

In 1926, A. W. Gregg, Esquire, who was then Solicitor of Internal Revenue, was asked to review Solicitor's Memorandum 3040, because of certain remarks appearing in the opinion of Viscount Cave in the House of Lords' decision in the case of *Commissioners of Inland Revenue* v. *Blott* (referred to in GREGG's opinion). The result of this reconsideration, which confirmed the holding in Solicitor's Memorandum 3040, was published as Solicitor's Memorandum 5363 in V-1 Cumulative Bulletin 89 (1926), wherein it was held:

> "The tax deducted from profits distributed as dividends is a tax against the shareholder. The tax deducted from interest payments or annual charges is a tax against the recipient of the interest or other annual payments. The tax on the profits which are retained by the corporation is a tax against the corporation."

These rulings have never been modified, amended or revoked. They were expressly followed in I. T. 2401, VII-1 Cumulative Bulletin 126 (1928). For the convenience of the Court, these rulings are set forth in full in the Appendix to this Brief. See also G. C. M. 3179, VII-1 Cumulative Bulletin 240 (1928). Further evidence of the settled practice and administrative interpretation of the credit provisions is found in *Robillard* v. *Commissioner*, 20 B. T. A. 685 (aff'd. 50 F. (2d) 1083, *certiorari* denied 284 U. S. 650, 76 L. ed. 551), in which the Commissioner stipulated to allow the taxpayer credit for British income taxes

deducted from dividends distributed, which action was approved by the Board of Tax Appeals in entering its order. Indeed, in the instant case, the Commissioner at first followed his long established practice and allowed the credit. Nearly two years after the petition herein was filed, the Commissioner filed an amended answer (R. 20) in which he denied, for the first time in the history of his office, that the credit should be allowed, and averred that "now" it should be disallowed (R. 21).

This Court has firmly established the rule that long standing construction and interpretation of a statute by those called upon to administer the law is entitled to great weight, and should not be overruled except for grave reasons: *McFeely* v. *Commissioner,* 296 U. S. 102, 109-110, 80 L. ed. 83, 89-90; *Burnet* v. *S. & L. Building Corp.,* 288 U. S. 406, 415, 77 L. ed. 861, 866; *McCaughn* v. *Hershey Chocolate Co.,* 283 U. S. 488, 492, 75 L. ed. 1183, 1187; *Fawcus Machine Co.* v. *United States,* 282 U. S. 375, 378, 75 L. ed. 397, 399; *Universal Battery Co.* v. *United States,* 281 U. S. 580, 583, 74 L. ed. 1051, 1055; *Brewster* v. *Gage,* 280 U. S. 327, 336, 74 L. ed. 457, 462. The rationale of this principle is expressed in the opinion of this Court in *United States* v. *Midwest Oil Co.,* 236 U. S. 459, 472-473, 59 L. ed. 673, 681:

> "It may be argued that while these facts and rulings prove a usage, they do not establish its validity. But government is a practical affair, intended for practical men. Both officers, lawmakers, and citizens naturally adjust themselves to any long-continued action of the Executive Department, on the presumption that unauthorized acts would not have been allowed to be so often repeated as to crystallize into a regular practice. That presumption is not reasoning in a circle, but the basis of a wise and quieting rule

> that, in determining the meaning of a statute or the existence of a power, weight shall be given to the usage itself,—even when the validity of the practice is the subject of investigation."

More recently this Court refused to disturb a settled administrative practice and construction of a taxing statute in *Universal Battery Co.* v. *United States, supra,* observing at page 583:

> "This construction of those terms has been adhered to in the Internal Revenue Bureau for about ten years, and it ought not to be disturbed now unless it be plainly wrong. We think it is not so, but is an admissible construction."

We cannot emphasize the fact too strongly that each of the Revenue Acts from 1918 through the Revenue Act of 1928 has re-enacted the foreign tax credit provisions without change. The re-enactments subsequent to 1928 contain the credit provisions, but impose slightly different limitations as to the use of the amount of tax deducted at the source. This Court has repeatedly held that Congress must be taken to have been familiar with the administrative interpretation embodied in published Internal Revenue Bureau rulings, and to have adopted and approved such interpretation and administrative practice when it subsequently re-enacted the statute without change: *McFeely* v. *Commissioner, supra; Helvering* v. *Bliss,* 293 U. S. 144, 151, 79 L. ed. 246, 251; *United States* v. *Dakota-Montana Oil Co.,* 288 U. S. 459, 466, 77 L. ed. 893, 898; *Massachusetts Mutual Life Insurance Co.* v. *United States,* 288 U. S. 269, 273, 77 L. ed. 739, 742; *Cook* v. *United States,* 288 U. S. 102, 120, 77 L. ed. 641, 650; *McCaughn* v. *Hershey Chocolate Co., supra; National Lead Co.* v.

United States, 252 U. S. 140, 146-147, 64 L. ed. 496, 499-500; *United States* v. *Cerecedo Hermanos y Compania*, 209 U. S. 337, 339, 52 L. ed. 821, 822.

The Court below, in failing to reverse the Board, disregarded the principle laid down by the cases just referred to, and has sanctioned the Commissioner's attempted repudiation of his long practice and published rulings. The statement of the Court below that "the clauses of the Revenue Act allowing credits and deductions for taxes paid to a foreign country * * * are clear without departmental interpretation" is not consistent with reality, when consideration is taken of the substantial number of Bureau Rulings which have been necessary to interpret these provisions, and the large number of cases now pending before the Board of Tax Appeals involving their application. Indeed, since the decision of the Court below in this case, the Circuit Courts of Appeals for the First and Third Circuits have reached a contrary conclusion on the same facts, confirming the original construction set forth in the Commissioner's rulings and applied in practice by him for over fifteen years.

Section 131 of the Revenue Act of 1928 is a relief provision intended to benefit the taxpayer and avoid international double taxation, and should be given such construction as will effectuate that purpose. See *Burnet* v. *Chicago Portrait Co.*, 285 U. S. 1, 15, 76 L. ed. 587, 595; *United States* v. *Updike*, 281 U. S. 489, 496, 74 L. ed. 984, 991.

Fifteen years of uninterrupted uniform construction and practice by the administrative department, approved by Congress without change in successive Revenue Acts, is of great weight. It is submitted that the practice was correct and proper, and, for this reason alone, this Court should reverse the decision of the Court below.

POINT III.

There was ample evidence to support the Board's findings of fact.

1. History of British Income Tax Legislation.

Income tax was first introduced in the United Kingdom in the year 1799. The first Act was framed upon the theory of direct assessment and collection from each taxpayer computed on the taxpayer's total income from all sources. Because of its inquisitorial character in making public the details of the taxpayer's income considerable objection to the Act was raised. In 1803 the Chancellor of the Exchequer completely remodelled the income tax structure and method of collection by introducing the principle of deduction of taxes at the source. In this way the modern system of income tax as it now exists in the United Kingdom, the very foundation of which is the principle of deduction of tax at the source, was set up. This change met the objections of those who derived their income from government and corporation holdings, because as the tax was deducted from their interest and dividends by the payor before making payment to them, it was no longer necessary for them to make individual returns. The significance of the principle of deduction of income tax at the source in the British system is illustrated by the fact that 70% of all the income of individuals is taxed in this manner (R. 145).

In 1918 all existing income tax acts were consolidated into what is known as the Income Tax Act of 1918. It is in force in the United Kingdom today, subject to such particular amendments as have been made from time to time by the Annual Finance Acts. Each Annual Finance

Act fixes the standard rate of income tax and the rates for sur-tax for the particular year in which it is passed, but the imposition, assessment, levy and collection of that tax is governed by the Income Tax Act of 1918, as amended. King's Printer's (Official) copies of the Income Tax Act of 1918 and the Finance Acts for the years 1919 to 1934, inclusive, were received in evidence and are included as a separate volume of the Record of this case (Appendix "A").

2. **Legislative Enactments of Parliament.**

The language used in the Sections of the British Income Tax Act of 1918 and the Finance Acts quoted below leaves no doubt that payment of income tax by deduction is, in the view of Parliament, the equivalent of payment under direct assessment, and that one who has suffered income tax to be deducted from his dividend income has paid that tax in every sense of the word.

Sec. 29, British Income Tax Act, 1918 (R. 138; Appendix "A", p. 14 of Exhibit No. 1), provides as follows:

> "If it is proved to the satisfaction of the general commissioners that any person whose claim for exemption, abatement, or relief has been allowed, *has paid any tax, by deduction or otherwise,* the general commissioners may, in the form prescribed, certify the facts proved before them to the special commissioners." (Italics ours.)

Sec. 32, Sub-section (2), British Income Tax Act, 1918 (R. 138-139; Appendix "A", p. 17 of Exhibit No. 1), provides as follows:

> "If any such person is charged to tax under any Schedule and *has paid that tax,* or *has paid or has*

been charged with tax by deduction or otherwise, he shall, on a claim being made to the special commissioners, and on production to them of the receipt for his annual payment, and proof of the facts to their satisfaction, be entitled to *repayment of tax* on the amount thereof." (Italics ours.)

Sec. 33, Sub-section (1), British Income Tax Act, 1918 (R. 139; Appendix "A", p. 19 of Exhibit No. 1), provides as follows:

> "Where an assurance company carrying on life assurance business, or any company whose business consists mainly in the making of investments, and the principal part of whose income is derived therefrom, or any savings bank or other bank for savings, claims and proves to the satisfaction of the special commissioners that, for any year of assessment, it *has been charged to tax by deduction or otherwise* * * *." (Italics ours.)

Sec. 27, Sub-section (1), Finance Act, 1920 (R. 139-140; Appendix "A", p. 21 of Exhibit No. 3), provides as follows:

> "If any person who *has paid, by deduction or otherwise,* or is liable to pay, United Kingdom income tax * * *." (Italics ours.)

Under the British Income Tax laws provision for the making of a direct assessment of income tax against a shareholder in respect of dividends, where the dividends may have escaped taxation by deduction, is contained in Sec. 211 (1) of the 1918 Act (R. Appendix "A", pp. 133-134 of Exhibit No. 1). It provides:

> "Where in any year of assessment any half-yearly or quarterly payments have been made on ac-

count of any interest, *dividends* or other annual profits or gains, previously to the passing of the Act imposing the tax for that year, *and tax has not been charged thereon or deducted therefrom, or has not been charged thereon or deducted therefrom at the rate ultimately imposed for the said year, the amount not so charged or deducted shall be charged under Schedule D* in respect of those payments, as profits or gains not charged by virtue of any other Schedule, under Case VI of Schedule D, and the agents entrusted with the payment of the interest, *dividends* or other annual profits or gains shall furnish to the Commissioners of Inland Revenue a list containing the names and addresses of the persons to whom payments have been made and the amount of those payments, upon a requisition made by those Commissioners in that behalf." (Italics ours.)

These statutory provisions indicate definitely that any income taxes deducted from dividends before payment to the shareholder are taxes paid by such shareholder.

3. **Decisions of the English Courts.**

The following language from the decisions of the English Courts fully sustain the Board's findings of fact.

In *Brooke* v. *Commissioners of Inland Revenue,* VII T. C. 261 (R. 217, 233), the Court said:

> "But I think it is fallacious to say that the individuals who receive income from which Income Tax is deducted at the source are not chargeable with the tax."

And later (R. 245)

> "It seems to me, with all respect to the argument, it makes no difference for this purpose whether the Income Tax is deducted at the source, under the opera-

n of what Lord Halsbury calls in the *Ashton Gas mpany* v. *The Attorney General* the somewhat diffi- t and complex machinery which makes the officers the company officers of the finance department of e Government for the purpose of collecting the tax, whether the tax is directly assessed upon the person question. She pays the tax and in my opinion she liable to pay Super-tax also."

Brooke case was expressly approved in *Williams er, et al.*, VII T. C. 387 (R. 249), the Master of the aying (R. 282):

"Again, it is not true to say that the Income Tax ts look only to the legal owners, as they contain ferences to persons who *pay* Income Tax either by y of deduction or otherwise. A person who pays come Tax by deduction is a taxpayer." (Italics urt's.)

Hamilton v. *Commissioners of Inland Revenue,* XVI 13 (R. 366), Lawrence, L. J., says (R. 405):

As my Lord has pointed out, the taxpayer is the areholder and, under this machinery, [i. e. Rule 20 the General Rules of the Income Tax Act, 1918] e company is made the collector of the shareholder's x for the Revenue."

The Testimony of the Expert.

e testimony of the expert fully substantiated the s of fact by the Board. He testified (R. 182):

"• • • according to my view, according to my ading of the English statutes, and according to my ading of the English decisions, and according to my perience extending over a number of years in the land Revenue Department, when tax is deducted

from a dividend or when a dividend is paid free of tax, the shareholder suffers and bears and pays the amount of the tax appropriate to the dividend."

Conclusion.

It is respectfully submitted that the decision of the Court below should be reversed and an Order entered directing the respondent to allow petitioner's claim for credit against Federal Income Taxes on account of British Income Taxes deducted from her dividends.

Dated: New York, N. Y.,
November 17, 1937.

Respectfully,

FRANK J. WIDEMAN,
FORREST HYDE,
FREEMAN J. DANIELS,
Counsel for Petitioner.

WILLIAM R. PERKINS,
Of Counsel.

APPENDIX.

BUREAU RULINGS REFERRED TO IN POINT II OF ARGUMENT.

S. M. 3040, printed at page 198 of IV-1 Cumulative Bulletin reads:

An opinion is requested in connection with a claim filed by A, which is based upon credit for income taxes paid to a foreign country under the provisions of section 222(a) of the Revenue Acts of 1918 and 1921. The taxpayer held stock in a company incorporated and operating in England and received dividends in amounts representing the net cash distribution after the company had deducted from the dividend the proportionate part of the income tax paid by it to the British Government. The following questions are presented:

1. Where under the income tax act, 1918, of Great Britain, the tax on the corporation is assessed upon its gains and profits, and the corporation is permitted to deduct the proportionate part of such tax from dividends, is the tax paid a tax upon the shareholder; and,

2. May such a tax be credited against the tax liability of the citizen of the United States?

Section 222(a) of the Revenue Act of 1918 provides:

> Sec. 222(a) That the tax computed under Part II of this title shall be credited with:
>
> In the case of a citizen of the United States, the amount of any income, war-profits and excess-profits taxes paid during the taxable year to any foreign country, upon income derived from sources therein, or to any possession of the United States; and * * *.

Section 222(a) of the Revenue Act of 1921 is substantially the same as the foregoing. The basis of the credit for taxes is stated in article 381, Regulations 45, as "the amount of any" such taxes paid or accrued "during the taxable year to any foreign country, upon income derived from sources therein," and the meaning of "taxes paid during the taxable year" is defined in article 382 as that "paid or accrued during the taxable year on behalf of the individual claiming credit." Under the income tax act, 1918, of Great Britain, which is an act to consolidate the enactments relating to income taxes, the tax upon corporate bodies is levied upon the profits and gains so that the full amount of earned and undistributed profits would be taxed in the hands of the corporation, but where dividends are declared, the corporation is permitted to deduct from such dividends a proportionate part of the tax before the distribution is made. The question that arises, therefore, is whether under that act the corporation is the taxable entity where taxes are deducted from dividends or whether taxes are accrued or paid to the British Government on behalf of the domestic shareholder so as to entitle him to credit for same under section 222.

The income tax act, 1918, of Great Britain, consolidates the income tax acts, 1842 and 1853, and the material provisions of all other statutes relating to income tax up to and including the finance act, 1918. This act contains practically all the statutory law relating purely to income tax, except that certain matters, *e. g.*, the rates of income tax, supertax, and the rates in respect to earned and unearned income are left to be provided by Parliament, with respect to each year of assessment, so that these provisions are contained in the annual finance acts. (See "Income Tax" by F. G. Underhay.) The acts subsequent to the

act of 1918, therefore, are of no value in the consideration of the instant case. Under the income tax act, 1918, the properties, profits, and gains in respect to which income tax is payable are classified under five schedules having reference to the different sources of income, and these schedules contain rules for estimating the tax payable upon the particular classes of property. The general rules covering these schedules, together with the pertinent provisions of the income tax act, 1842, which is reenacted by the 1918 act, provide as follows:

> 1. Every body of persons shall be chargeable to tax in like manner as any person is chargeable under the provisions of this act.
>
> Act of 1842-40. (And be it enacted, that) all bodies politic, corporate, or collegiate, companies, fraternities, fellowships, or societies of persons, whether corporate or not corporate, shall be chargeable with such and the like duties as any person will under and by virtue of this act be chargeable with, and that the chamberlain or other officer acting as treasurer, auditor, or receiver for the time being of every such corporation, company, fraternity, fellowship, or society shall be answerable for doing all such acts, matters, and things as shall be required to be done by virtue of this act, in order to the assessing such bodies, corporate, companies, fraternities, fellowships, or societies to the duties granted by this act, and paying the same.
>
> 20. The profits or gains to be charged on any body of persons shall be computed in accordance with the provisions of this act on the full amount of the same before any dividend thereof is made in respect of any share, right, or title thereto, and the body of persons paying such dividend shall be entitled to deduct the tax appropriate thereto.
>
> Act of 1842-54. (And be it enacted, that) every such officer before described (a) of any corporation,

fraternity, fellowship, company, or society, shall also, within the like period prepare and deliver in like form and manner a true and correct statement of the profits and gains to be charged on such corporation, fraternity, fellowship, company, or society, computed according to the directions of this act, together with such declaration of the manner of estimating the same as aforesaid; (b) and such estimate shall be made on the amount of the annual profits and gains of such corporation, fraternity, fellowship, company, or society before any dividend shall have been made thereof to any other persons, corporations, or companies having any share, right, or title in or to such profits or gains; (c) and all such other persons, and corporations or companies, shall allow out of such dividends a proportionate deduction in respect of the duty so charged; (d) Provided always, that nothing hereinbefore contained shall be construed to require in such statement the inclusion of salaries, wages, or profits of any officer of such corporation, fraternity, fellowship, company, or society, otherwise chargeable under this act; (e) (Provided also, that the statements of the several companies of the East India and South Sea shall be made exclusive of the dividends and the profits attached thereto, and to be divided amongst the proprietors of the respective stocks belonging to such companies).

The procedure under this act for the assessment of corporations and the collection of taxes where dividends have been paid to the stockholders, is outlined in the case of *Mylam, Surveyor of Taxes,* v. *The Market Harborough Advertiser Co., Ltd.* (21 T. L. R., 201; Great Britain Tax Cases, vol. 5, p. 95). This case involved the claim of a corporation for exemption as a "person" on the ground that its total income was less than the statutory limitation, and the court says:

Under section 54 the corporate body making an income is bound by its proper officer to make a return of its profits, and to estimate those profits before any dividend has been paid over to any shareholder or other person entitled to the benefits of the corporation, and in due course to pay them, and all such persons are to allow out of their dividends a proportionate deduction in respect of the duty so charged. Therefore, in this case the company by their proper officer is bound in the first instance to make a return showing what their profits will be before any dividend is made, and then they are entitled, in paying their dividend, to deduct from that dividend as against each recipient his quota of the common income tax on the whole return of the corporate body. That being so, there is no reason for the exemption of the corporation, and the exception upon the exemption in this section certainly applies. The corporation loses nothing by paying the income tax, because they deduct it from their shareholders. Therefore, there is no reason why they should be exempted. The shareholders may or may not be entitled, as being themselves in receipt of a smaller income than £160 a year, to exemption. In that case the procedure is well known. They must accept the dividend minus the income tax, and they must send a certificate that such is their dividend to the office of the inland revenue, with proper declarations, and get their income tax returned to them.

In making the corporation chargeable with taxes computed u on the profits and gains of the corporation, and which taxes are deductible from dividends, the question arises as to whether it is contemplated by the act to regard the corporation as the taxable entity or whether it is a method of collecting tax at the source and holding the officers of the corporation responsible for the payment of same on behalf of the shareholder. In order that a citi-

zen of the United States may deduct any income, war-profits and excess-profits taxes under the provisions of section 222 (a) of the Revenue Act of 1918, the taxes must be paid or accrued during the taxable year on behalf of the individual claiming credit.

In the case of *Sir Marcus Samuel Bart* v. *The Commissioner of Inland Revenue* (vol. 7, Great Britain tax cases, p. 277, reported 34 T. L. R. 552), the appellant was the holder of certain shares of common stock and, under the authority of a resolution of the directors duly confirmed by the company at its annual meeting, the dividends upon these shares were to be paid free of income tax. In arriving at the supertax assessments, the commissioners by whom such assessments were made computed the portion of the income of the appellant derived from dividends by adding to the actual sums received the amount of the income tax in respect thereto. It was contended by the appellant that when a company declares a dividend free of tax it in effect made a present to the shareholder with the amount of the tax and that such voluntary payment could not be regarded as a portion of the income of the shareholder, either for income tax or supertax purposes, and that the real income of the appellant from the shares in question was the amount for which he could maintain an action against the company—that is, the amount which was actually paid to him. The opinion of the court states as follows:

> Supertax is payable under section 66 of the finance (1909-10) Act 1910, which provides that "In addition to the income tax charged at the rate of one shilling and twopence under this act, there shall be charged, levied, and paid for the year beginning on the 6th day of April, 1909, in respect of the income of any indi-

vidual, the total of which from all sources exceeds £5,000, an additional duty of income tax (in this act referred to as supertax) at the rate of sixpence for every pound of the amount by which the total income exceeds £3,000." The figures have been altered in subsequent acts.

It is further provided by section 54 of the act of 1842, that a company shall pay income tax on behalf of its shareholders, the marginal note of the section reading "Officers of corporations to prepare statements of profits and gains to be charged, estimated on the annual profits before dividend made." And it is provided that "all such persons and corporations or companies shall allow out of such dividends a proportionate deduction in respect of the duty so charged."

* * * * * * *

In my view this question is concluded by authority. In the case of *Attorney General* v. *Ashton Gas Co.* ((1904) 2 Ch., 621), it was held that "where by a special act of a gas company it was provided that the profits divisible in any year amongst the ordinary shareholders should not exceed a given rate, in calculating the rate of dividend income tax ought to be included." * * *.

The court also refers to the remarks of Lord Justice SWINFEN EADY in *Brooke* v. *Commissioners of Inland Revenue* (7 T. C., 261 (1918); 1 K. B., at p. 257), where he says:

"Where the duty is paid by a company in respect of the gains and profits of its business, it pays the income tax as agents for its shareholders," and Lord Justice SCRUTTON at page 270 says: "I am quite clear that a company, in paying income tax at the source at any rate, pays as agent of the shareholders."

In the *Brooke* case referred to, Sir T. ROLLS WARRINGTON, Lord Justice of the Court of Appeals, in his concurring opinion, used the following language:

> For these reasons I think that, in this case at all events, the appellant is liable to the supertax in respect of her income, as it is income entirely derived from property in this country. It seems to me, with all respect to the argument we have heard, that it makes no difference for this purpose whether the income tax is deducted at the source under the operation of what Lord HALSBURY calls in *Ashton Gas Co.* v. *Attorney General* the "somewhat difficult and complex machinery which makes the officers of the company officers of the financial department of the Government for the purpose of collecting the tax," or whether the tax is directly assessed upon the person in question. The appellant here pays income tax, although the tax is deducted at the source, and in my opinion she is liable to pay supertax also.

And Lord Justice SCRUTTON:

> I am not at present satisfied that the reasoning in *Purdie* v. *Rex* is consistent with the decision of the House of Lords in *Ashton Gas Co.* v. *Attorney General;* but it is not necessary, in my view of this case, to decide that point, because I am quite clear that a company in paying income tax at the source at any rate, pays as agent of the shareholders.

In view of these decisions, it is the opinion of this office that where under the income tax act, 1918, of Great Britain, a tax is paid to the British Government by a corporation on the basis of its profits and gains which is deductible by the corporation from the dividends paid its shareholders, such tax is a tax against the shareholders and may be taken as a credit by a citizen shareholder of the United

States under section 222 of the Revenue Acts of 1918 and 1921. Although the corporation is held chargeable to tax, the decisions cited above construe the provision permitting the deduction of taxes from dividends as being a payment of tax on behalf of the shareholders, or a collection at the source. It is concluded, therefore, that in the instant case where a citizen of the United States receives dividends from a British corporation, from which a proportionate part of the tax paid to the British Government has been deducted, such payment of tax comes within the contemplation of section 222(a) of the Revenue Acts of 1918 and 1921 as a tax paid to a foreign country.

NELSON T. HARTSON,
Solicitor of Internal Revenue.

S. M. 5363, printed at page 89 of V-1 Cumulative Bulletin reads:

The M Company, a foreign corporation maintaining a branch in the United States, submits the following inquiries:

1. Whether a foreign corporation is entitled to any deduction from gross income for taxes paid abroad by the home office on income earned within the United States.

2. Whether the entire amount of income tax paid by the corporation to the British Government on gains and profits is a tax against the corporation or against its shareholders.

3. Whether the entire amount of tax paid to the British Government on gains and profits from sources within the United States may be deducted from gross income in accordance with the provisions of section 234(a)3 and section 234(b).

4. In case the entire amount of such taxes is not an allowable deduction, what portion is allowable?

The questions submitted arise in connection with the taxpayer's contention that the portion of the British income taxes paid by the company for the year 1922 on gains and profits from sources within the United States should be allowed as a deduction in computing net income in accordance with the provisions of section 234(a)3 and section 234(b) of the Revenue Act of 1921.

The Unit disallowed any portion of the British taxes paid by the home office, for the reason that "such taxes appear to be a liability of the shareholders and not of the corporation, and were not imposed on income earned

during the year 1922." This ruling was apparently based on the opinion expressed in Solicitor's Memorandum 3040 (C. B. IV-1, 198), to the effect that where, under the income tax act of 1918 of Great Britain, a tax is paid to the British Government by a British corporation on the basis of its profits and gains which is deductible by the corporation from the dividends paid its shareholders, such tax is a tax against the shareholders and may be taken as a credit by a citizen shareholder of the United States under section 222 of the Revenue Acts of 1918 and 1921.

The Company has protested this ruling, and submits that under the British income tax act the corporation is the taxpayer and does not pay the tax as agent for its shareholders. In substantiation of this, it quotes as follows from the opinion of Viscount Cave in the House of Lords decision in the case of *Commissioners of Inland Revenue* v. *John Blott* (H. L., 1921, 2 A. C., 171):

> Some time was occupied in the discussion of the question whether, in paying income tax on its profits, the company acted as agent for its shareholders, and some cases were cited where this expression had been used. Probably the word was intended only to express in an abbreviated form the effect of section 54 of the income tax act, 1842. Plainly, a company paying income tax on its profits does not pay it as agent for its shareholders. It pays as a taxpayer, and if no dividend is declared the shareholders have no direct concern in the payment. If a dividend is declared, the company is entitled to deduct from such dividend a proportionate part of the amount of the tax previously paid by the company; and, in that case, the payment by the company operates in relief of the shareholder. But no agency, properly so called, is involved.

Request is made that Solicitor's Memorandum 3040 be reconsidered, in the light of the decision referred to above, and that a reply be then made to the four inquiries submitted.

The questions which were submitted and considered in Solicitor's Memorandum 3040 are stated as follows:

> (1) Where under the income tax act, 1918, of Great Britain the tax on the corporation is assessed upon its gains and profits, and the corporation is permitted to deduct the proportionate part of such tax from dividends, is the tax paid a tax upon the shareholder; and,
>
> (2) May such a tax be credited against the tax liability of the citizen of the United States?

These questions were combined and restated to read:

> The question that arises, therefore, is whether under that act the corporation is the taxable entity where taxes are deducted from dividends or whether taxes are accrued or paid to the British Government on behalf of the domestic shareholder so as to entitle him to credit for same under section 222.

After consideration of the pertinent provisions of the British law and of decisions in British tax cases involving such provisions, the following conclusion was reached:

> In view of these decisions, it is the opinion of this office that where under the income tax act, 1918, of Great Britain, a tax is paid to the British Government by a corporation on the basis of its profits and gains which is deductible by the corporation from the dividends paid its shareholders, such tax is a tax against the shareholders and may be taken as a credit by a citizen shareholder of the United States under section 222 of the Revenue Acts of 1918 and 1921. Although the corporation is held chargeable to tax, the decisions cited above construe the provision permitting the de-

duction of taxes from dividends as being a payment of tax on behalf of the shareholders, or *a collection at the source*. It is concluded, therefore, that in the instant case where a citizen of the United States receives dividends from a British corporation, from which a proportionate part of the tax paid to the British Government has been deducted, such payment of tax comes within the contemplation of section 222(a) of the Revenue Acts of 1918 and 1921 as a tax paid to a foreign country. [Italics supplied.]

The substance of the ruling is that the tax deducted by a British corporation from that portion of its profits distributed as dividends is a tax paid by the shareholders at the source, which may, in case the shareholder is a citizen of the United States, be claimed as a credit against the tax due the United States under the provisions of section 222. The question submitted related only to the tax deducted from the dividends paid, and the conclusion refers only to such tax. The ruling was not intended to apply to the tax on the profits retained by the corporation.

The question involved in the case of *Commissioners of Inland Revenue* v. *Blott,* cited above, was whether bonus shares (stock dividends) were income to the shareholder and therefore subject to supertax in his hands. It was held that the bonus shares, being distributed by the company as capital, were not income in the hands of the shareholder which he was required to include in his return of total income from all sources for the purposes of supertax. It is the opinion of this office that the Blott decision in no way affects the soundness of the conclusion reached in Solicitor's Memorandum 3040.

That the conclusion in Solicitor's Memorandum 3040 is correct is borne out by certain statements contained in

that part of the report of the Commissioners of Inland Revenue for the year ended March 31, 1922, which relates to income tax. This part of the report contains a general description of the British income tax and the information contained therein may be considered as representing the official interpretation and application of the British income tax law. The following paragraphs are quoted, because they have a bearing on the conclusion reached in Solicitor's Memorandum 3040 as to the British tax deducted from dividends paid by a British corporation and on the questions submitted in the case under consideration:

Outline of the Tax.

1. * * * In the main it is a tax on the incomes of individuals. This fact may be illustrated by Table 67 of our last report, which showed that out of a total actual income of £2,547,179,823 assessed to tax in 1919-20 nearly 90 per cent was distributed among individuals resident in the United Kingdom. The remaining 10 per cent *accrued to and was retained by corporate bodies—e. g., undistributed profits of limited liability companies*—or accrued to persons resident outside the United Kingdom. * * * *The object of the operations of assessment and collection of the tax is to secure* that every individual pays just that amount of tax which is proper to his particular total income and circumstances, and *that all non-personal income bears tax at the standard rate of tax in force for the year of assessment.*

The General Scope of the Tax.

2. Income tax extends, broadly speaking, to:

(a) All income arising in the United Kingdom, by whomsoever it may be enjoyed; and

(b) All income accruing to a person residing in the United Kingdom, without regard to the place where it may arise.

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3. The expression "person residing in the United Kingdom" includes, as well as individuals, companies or other bodies or associations of individuals.

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SCHEDULE D. 1921-22.

27. Case 1. Broadly speaking, trade profit brought into the computation of the assessment is the difference between the gross receipts and the expenses incurred wholly and exclusively for the purposes of the business. * * * The acts prohibit deductions in respect of capital charges, lost capital, losses unconnected with the business, and private and domestic expenses. They also prohibit, under the system of collection at the source (see par. 41 *et seq.*), the deduction of certain charges which would normally be regarded as commercial expenses. Such charges include any annual interest on borrowed money, annuity, or other annual payment payable out of the profit and any royalty in respect of a patent. The total profit brought into the computation of the assessment thus includes those charges, but as the trader is entitled on paying the interest, royalty, etc. to deduct therefrom income tax at the standard rate of tax appropriate to the period to which the interest, royalty, etc. relates, he recovers in this manner the tax relating to that part of the total profits paid away to other persons.

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COLLECTION OF THE TAX.

41. The peculiar distinction of the British income tax is collection at the source. Broadly speaking, whenever it is possible to do so, tax is obtained by deducting

it before the income reaches the person to whom it belongs. Wherever possible, the formal assessment is laid on each source of income by itself, and on persons who are debtors in respect of income belonging to other persons. Power is given to the payers of income to deduct the appropriate tax from the payments made to the ultimate proprietors of that income. For instance, * * * a limited liability company is assessed to tax at the standard rate on the whole of its profits, without reference to the ultimate destination of those profits. On paying interest to its debenture holders or dividends to its shareholders, the company is entitled to deduct and retain the amount of tax appropriate to the interest paid or dividend distributed, and the investor thus receives his interest or dividend subject to this deduction of tax.

42. The principal classes of income on which tax is collected by deduction at the source are the following—

* * * * * * * *

Schedule D. Dividends, debenture and other interest paid by limited liability companies; interest and dividends payable by dominion and foreign companies through agents in the United Kingdom; coupons for dividends payable abroad which are realized through a banker or coupon dealer in the United Kingdom; patent royalties; annual interest and annuities payable under contracts.

* * * * * * * *

It is estimated that in 1921-22 approximately 67 per cent. of the net yield of the tax was collected at the source.

43. Whether the tax charged in respect to any income brought into assessment is collected by deduction at the source or not thus depends upon the *ultimate proprietorship* of the income assessed. So far as the

person charged is not the ultimate proprietor, the tax is collected by deduction at the source; so far as he is, the tax is collected directly. The chief classes of income in respect of which the tax is collected directly are the profits from trade of individuals, whether sole or partnership traders, *the like profits of limited liability companies so far as they are not distributed to shareholders, debenture holders, etc.;* profits from the occupation of land; income from professions and most employments; income from dominion and foreign securities and possessions not paid through agents in the United Kingdom; income from certain interest, discounts, etc.

44. The income of limited liability companies is charged in the assessments at the full standard rate of tax. With certain exceptions, income on which tax is collected at the source is similarly charged and tax is deducted from the recipient of the income at the full standard rate. * * * [Italics supplied.]

In view of the foregoing, the ruling in Solicitor's Memorandum 3040 is hereby affirmed.

Whether the taxpayer is correct in its contention that a foreign corporation is entitled to a deduction on account of the British income taxes paid by the home office on gains and profits from sources within the United States depends on the proper interpretation of the following provisions of section 234 of the Revenue Act of 1921:

Sec. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

* * * * * * * *

(3) Taxes paid or accrued within the taxable year except * * * (b) so much of the income, war-profits, and excess-profits taxes imposed by the au-

thority of any foreign country or possession of the United States as is allowed as a credit under section 238 * * *.

(b) In the case of a foreign corporation or of a corporation entitled to the benefits of section 262 the deductions allowed in subdivision (a) shall be allowed only if and to the extent that they are connected with income from sources within the United States; and the proper apportionment and allocation of the deductions with respect to sources within and without the United States shall be determined as provided in section 217 under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

Income taxes imposed by a foreign country on income from sources within the United States are taxes connected with income from sources within the United States. Section 234(b) permits such taxes to be deducted, therefore, if they are allowed as a deduction under the provisions of subdivision (a). Subdivision (a) 3 allows as a deduction *all* taxes paid or accrued during the taxable year with three exceptions, the second of which relates to foreign income and profits taxes. If the foreign income taxes come within this exception, they are not deductible. If they do not come within the exception, they are deductible. The exception includes only *so much* of the foreign income and profits taxes as is allowed as a credit under section 238. It follows that *so much* of the foreign income and profits taxes as is *not* allowed as a credit is deductible. Inasmuch as a foreign corporation is not allowed any credit under section 238, none of the foreign income taxes paid by it come within the exception.

It is held, therefore, that a foreign corporation is entitled to a deduction on account of income and profits taxes paid to a foreign country on income from sources within the United States.

The taxpayer in the instant case being a foreign insurance company, other than a life or mutual company, is subject to the tax imposed by section 246 and is required to compute its net income in accordance with sections 246 and 247. Such a company is allowed to deduct taxes as provided in section 234(a)3 to the extent provided in section 234(b). The contention of the taxpayer is correct, and it is entitled to a deduction of the income and profits taxes paid to Great Britain on income from sources within the United States.

It now becomes necessary to determine what portion of the British income tax paid by the home office can be said to be based on the income from sources within the United States. Section 234(b) provides that the proper apportionment and allocation of deductions with respect to sources within and without the United States shall be determined as provided in section 217 under rules and regulations prescribed by the Commissioner, with the approval of the Secretary. Such rules and regulations have been prescribed in article 325 of Regulations 62 for the apportionment of deductions in the case of nonresident alien individuals. These regulations are also applicable in the case of foreign corporations. This article provides that in the case of a deduction which is not definitely allocated to income from sources within the United States or to income from sources without the United States, a ratable part thereof based upon the relation of gross income from sources within the United States to total gross income from all sources shall be deducted in computing net income from sources within the United States.

The next step is to determine the amount of the British income tax borne by the corporation which is to be used as a basis for determining the portion allocable to American income. The statements made in the report to the

Commissioners of Inland Revenue, which are quoted above, clearly show that the income tax which a British corporation actually bears is the tax on the profits it retains. This may or may not be the tax assessed against it on its gains and profits and paid by it to the British Government. The tax on the profits distributed as dividends is not borne by the corporation, but the tax deducted from dividends received by the corporation is borne by the corporation. (S. M. 3040.)

The following provision of the British law shows that the tax on that portion of the profits which are paid out as interest or other annual charges is a tax borne by the recipient of such interest or other income:

General rules applicable to schedules A, B, C, D, and E.

19. (1) Where any yearly interest of money, annuity, or any other annual payment (whether payable within or out of the United Kingdom, * * *), is payable wholly out of profits or gains brought into charge to tax, no assessment shall be made upon the person entitled to such interest, annuity, or annual payment, but the whole of those profits or gains shall be assessed and charged with tax on the person liable to the interest, annuity, or annual payment, without distinguishing the same, and the person liable to make such payment, whether out of the profits or gains charged with tax or out of any annual payment liable to deduction, or from which a deduction has been made, shall be entitled, on making such payment, to deduct and retain thereout a sum representing the amount of the tax thereon at the rate or rates of tax in force during the period through which the said payment was accruing due.

The British income tax forms prescribed for the use of individuals, require annual interest, other annual pay-

ments and dividends, to be reported as "Income subjected to United Kingdom income tax before receipt."

In view of the provisions of the British law, it is clear that the amount of income tax actually borne by a British corporation for a given year is the tax directly assessed against it plus any tax withheld from income received by the corporation during the year, less (*a*) the tax deducted and retained on annual charges on profits reported for tax and (*b*) the tax on profits distributed as dividends.

For the years 1920 to 1924 British corporations were also liable for corporation profits tax, which was a direct tax on corporations, no part of which was authorized to be collected from the shareholders.

The basic figure for the determination of the British income and profits taxes of a British corporation is the income tax actually borne by the corporation computed as described above plus the corporation profits tax for the same year.

Although the British tax year is from April 6 to April 5, and any change in the tax rates becomes effective on April 6, the profits of trade or business are allowed to be computed for the period on which the accounts are kept. In the instant case, the accounts were made up for the calendar year, and the British income tax returns were filed on that basis.

While the British income tax on the profits of a given year, which is charged directly against a corporation, is measured by the average of the profits for the three preceding years, it is nevertheless a tax on the profits of the taxable year. In the case of a British corporation, therefore, the actual total gross income from all sources for the taxable year is the income to be compared with gross income from sources within the United States for the same

year in determining what proportion of British income tax is allocable to American income.

(1) A foreign corporation is entitled to a deduction from gross income for taxes paid to a foreign government by the home office on income from sources within the United States.

(2) The entire income tax paid by a British corporation to the British Government for a given year on its gains and profits may or may not be borne by the corporation. The tax which it bears is the tax directly assessed against it on its gains and profits plus any tax withheld from income received by the corporation during the year, less (*a*) the tax deducted and retained on annual charges on profits reported for tax and (*b*) the tax on the profits distributed as dividends.

The tax deducted from profits distributed as dividends is a tax against the shareholder. The tax deducted from interest payments or annual charges is a tax against the recipient of the interest or other annual payments. The tax on the profits which are retained by the corporation is a tax against the corporation. The entire corporation profits tax is a tax against the corporation.

(3) and (4) That portion of the British income and profits taxes actually borne by a British corporation which is allocable to income from sources within the United States may be deducted from gross income in accordance with the provisions of section 234(a)3 and section 234(b) of the Revenue Acts of 1921 and 1924. The portion allocable is determined in accordance with article 325, Regulations 62, and article 326, Regulations 65.

A. W. GREGG,
Solicitor of Internal Revenue.

I. T. 2401, printed at page 126 of VII-1 Cumulative Bulletin reads:

Inquiry is made as to whether an American corporation which is the majority shareholder of a British corporation may claim credit under section 238(e) of the Revenue Act of 1926 with respect to the tax borne by the British subsidiary on undistributed profits, as well as credit for the amount of tax deducted from the dividends distributed to the parent corporation.

The following excerpts from section 238(a) and (e) of the Revenue Act of 1926 are pertinent to the question presented:

> (a) In the case of a domestic corporation the tax imposed by this title shall be credited with the amount of any income, war-profits, and excess-profits taxes paid or accrued during the same taxable year to any foreign country, or to any possession of the United States: * * *.
>
> * * * * * * * *
>
> (e) For the purposes of this section a domestic corporation which owns a majority of the voting stock of a foreign corporation from which it receives dividends (not deductible under section 234) in any taxable year shall be deemed to have paid the same proportion of any income, war-profits, or excess-profits taxes paid by such foreign corporation to any foreign country or to any possession of the United States, upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits: * * *.

It is held that inasmuch as the total British income tax paid on profits distributed as dividends by a British corporation to its shareholders is a tax imposed on the shareholder, the American corporation may claim as a

credit under section 238(a) the amount of tax paid to the British Government with respect to the dividends distributed, the same as a citizen shareholder might claim a like credit under section 222(a). (See S. M. 3040, C. B. IV-1, 198, and S. M. 5363, C. B. V-1, 89.) No credit is allowable to the majority shareholders under section 238(e) with respect to the tax paid by the subsidiary on the profits which it retains, for the reason that (1) no part of such tax was paid with respect to the profits distributed as dividends, the entire amount of the tax paid on the profits distributed as dividends being a credit under section 238(a), and (2) the tax paid on the profits which the subsidiary retains will be passed on to the shareholder when such profits are distributed as dividends and will then be a credit under section 238(a).

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